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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 4[redacted] 2

NEW WORLD LIFE INSURANCE COMPANY,
A CORPORATION,
Petitioner,

vs.

THE UNITED STATES.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF.

WALTER E. BARTON,
Washington, D. C.,
Counsel for Petitioner.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 417

NEW WORLD LIFE INSURANCE COMPANY,
A CORPORATION,
Petitioner,

vs.

THE UNITED STATES.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, New World Life Insurance Company, respectfully submits its petition for a writ of certiorari to review the judgment of the Court of Claims of the United States in the above entitled case.

Jurisdiction.

The judgment of the Court of Claims was entered on March 6, 1939 (R. 60). Motion for new trial was filed on May 5, 1939 (R. 60), and denied by the Court below on May 29, 1939 (R. 60). An extension of time until October

1, 1939 within which to file a petition for a writ of certiorari herein was granted by this Honorable Court on August 11, 1939 (R. 70). The jurisdiction of this Honorable Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939. (28 U. S. Code, § 288 (b); c. 229, § 3, 43 Stat. 939; U. S. Code Current Service (1939), No. 6, p. 835.)

Nature of Controversy.

This is a suit by the petitioner, a life insurance company, in the Court of Claims for the recovery of income taxes for the years 1929 to 1932, inclusive, after timely filing and rejection of claims for refund for said respective years.

The petitioner claimed a deduction for investment expenses under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932, of portions of total salaries paid to its officers and cashiers for services rendered in its investment department. For instance, if one-half of the total time of the officer or cashier was devoted to the investment department, one-half of the total salary paid to him was charged on the books and deducted in petitioner's income tax return as investment expenses. The Court of Claims held that the amount charged as investment expenses was an assignment of general expenses to investment expenses within the meaning of said section, and that it was not deductible (R. 45).

Another question was whether petitioner was entitled to a deduction under Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932 of the statutory percentage of the mean of Reserves for Total and Permanent Disability Benefits, Active Lives and Disabled Lives. The Court of Claims denied the deduction (R. 59-60).

Statement of the Case.

The material facts as found by the Court of Claims are as follows:

Petitioner is a stock life insurance company organized under the laws of the State of Washington. On November 22, 1929 petitioner's Board of Directors passed the following resolution, which was in effect during the taxable years 1929 to 1932, inclusive:

> "That in connection with office salaries paid, the Company's disbursements for such purposes during the year 1929 and in succeeding years, until by proper Board Resolution the ratios herein shall be changed, shall be charged as between Investment and Insurance expense in the following proportions:

Name.	Investment.	Insurance.
John J. Cadigan (President)	50%	50%
Edward J. O'Shea (Treasurer)	80%	20%
Graves, Mizer & Graves (General Counsel)	75%	25%
R. L. McGinnis	100%	
F. W. Maddux	100%	
Cashier in Seattle Office	25%	75%
Cashier in Oakland Office	50%	50%
Cashier in Portland Office	25%	75%
Cashier in Los Angeles Office	50%	50%
Cashier in San Diego Office	25%	75%
All employees in home office Investment Department	100%	
All employees in home office Policy Loan Department	100%"	

(R. 17, 24).

The percentages set forth in said resolution represented, in the case of officers, estimates arrived at by the respective officers, and in the case of cashiers, estimates arrived at by supervising officers in charge of such cashiers, after a careful consideration of the duties theretofore performed by such officers and cashiers, respectively, and which it was estimated they would perform in the future. The officers and cashiers, respectively, devoted at least as much of their time to the investment department of petitioner's business

for the taxable years involved as the percentages set forth in the resolution (R. 25).

Petitioner paid the following total salaries to its officers and cashiers for services rendered in both departments:

	1929.	1930.	1931.	1932.
President	$18,000.00	$18,000.00	$18,000.00	$18,000.00
Treasurer	8,500.00	9,875.00	10,000.00	10,000.00
General Counsel	1,800.00	1,800.00	3,112.50	5,619.08
Office Cashiers[1]	.....	7,795.64	10,805.28	11,960.00

(R. 30.)

[1] Four in 1930 and five in 1931 and 1932.

Petitioner charged to its investment department and deducted as investment expenses in its income tax returns for 1929 to 1932, inclusive, amounts equal to the same percentages of the total salaries paid to its officers and cashiers, which said resolution provided should be charged as investment expenses; to wit:

1929	$17,149.92
1930	21,387.58
1931	24,004.99
1932	26,559.43

(R. 18-22, 25).

The Commissioner disallowed the above deductions for salaries paid to petitioner's officers and cashiers for part-time services rendered in its investment department, but allowed other deductions for investment expenses, including salaries of officers and employees who devoted their entire time to the investment department, as follows:

1929	$38,730.29
1930	41,197.85
1931	36,895.42
1932	32,016.95

(R. 18-23).

Petitioner writes non-participating policies of life insurance, such as straight life, twenty payment life, endow-

ment, etc., some of which also include provisions for total and permanent disability benefits and accidental death benefits. Petitioner issues some separate life policies but issues no separate disability and/or accidental death policies. Petitioner's life insurance contracts and its combined life, health and accident insurance contracts constitute all of the classes of insurance issued by it, all of which are written on the level premium plan (R. 17, 25-26).

On each policy covering combined life, health and accident insurance, the total premium shown on the face of the policy includes the life premium, the disability premium, and the accident premium, the last two of which are also stated separately elsewhere in the policy (R. 26).

The cancellation or termination of the life insurance automatically cancels or terminates the disability and accident insurance. The policyholder may discontinue the disability and/or accident insurance at any premium-paying date without discontinuing the life insurance, in which event the total premium shown on the face of the policy is correspondingly reduced (R. 26).

The disability and accidental death benefits are not included in any paid-up term insurance, or other paid-up benefits granted upon the surrender or lapse of the policy; nor does any reserve held on account thereof enter into the amount of the separate reserve held for the life insurance covered by the policy, or the surrender, cash or loan values shown in the "Table of Loan and Nonforfeiture Values" (R. 26).

A sample combined life, health and accident insurance policy issued on May 1, 1932, to John Doe at age 35, for $1,000.00, the same being non-participating, endowment at age 85, premiums payable for 20 years, and containing total and permanent disability and accidental death benefits, is in the record and marked "Stipulation Exhibit D" (R. 26, 61).

Petitioner sets up out of the life premiums, a separate life reserve, and out of the accident premiums, a separate reserve for accidental death benefits, neither of which is in controversy here. Petitioner also sets up a separate reserve out of the disability premiums, commonly known as Reserve for Total and Permanent Disability Benefits, Active Lives, hereinafter referred to as "Disability Reserve, Active Lives." This reserve relates to outstanding disability insurance in force with respect to which total and permanent disability has not occurred (R. 27, 29).

In calculating the disability premium, the rate of disability, the rate of mortality, the rate of interest, and the rate of expense are taken into consideration. The first three determine the net disability premium, which is the amount that in connection with a given number of lives will be exactly sufficient to pay all disability claims of the group, according to the adopted combined mortality and disability table (usually Hunter's Combined Table of Mortality and Disability), if it is invested immediately at the rate of interest assumed (usually 3 to 3½ *per centum* compound interest) (R. 28).

When a person carrying disability insurance becomes totally and permanently disabled, petitioner transfers a certain amount from its Disability Reserve, Active Lives to another reserve commonly called "Reserve for Total and Permanent Disability Benefits, Disabled Lives," hereinafter referred to as "Disability Reserve, Disabled Lives." The amount transferred is calculated upon the basis of selected tables of probabilities of length of disability and expected benefits (such as Hunter's Disabled Lives Mortality Table), improved with an assumed rate of interest (usually 3½ *per centum* compound interest), mortality also being taken into consideration. When a policyholder becomes totally and permanently disabled, it is not possible to determine the amount of the disability benefits likely to be-

come payable under the policy, due to the fact that disability payments cease upon the death of the disabled person, and also upon the discontinuance of his disability while living (R. 28-29).

The mean of petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives held at the beginning and end of the taxable years involved was:

	Active Lives.	Disabled Lives.
1929	$78,562.76	$60,994.28
1930	65,871.14	95,432.05
1931	68,593.97	123,439.49
1932	90,725.50	131,206.50

(R. 29, 30.)

Petitioner's Disability Reserve, Active Lives was computed in accordance with standard combined mortality and disability tables, and its Disability Reserve, Disabled Lives was computed in accordance with standard mortality and disability tables for disabled lives, with interest rates in the case of each reserve as required by the laws of Washington, and/or the rules and regulations of the Insurance Commissioner of that State. Petitioner deducted the statutory percentage of the mean of said reserve funds held by it at the beginning and end of the taxable years 1929 to 1932, inclusive, as provided in Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932 (R. 29).

The Regulations [2] from 1921 until 1935 authorized a deduction of the statutory percentage of the mean of the Disability Reserve, Active Lives and the Disability Reserve, Disabled Lives. Furthermore, Form 1120-L (corporate life insurance income tax return prepared by the Commissioner)

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[2] This paragraph was not covered by the findings, but the regulations were brought to the attention of the court below in the briefs and in the oral argument, and the court referred to them in its opinion.

contained lines for said deductions. On December 18, 1935, T. D. 4615 amended the regulations applicable to the Revenue Act of 1932 and prior Revenue Acts by omitting therefrom the authorization for, but not expressly denying said deductions. The original Regulations applicable to the Revenue Acts of 1921, 1924, 1926, 1928 and 1932, inclusive, contain a specific authorization for a deduction with respect to disability reserves *not required by law* in the case of life insurance companies issuing policies covering life, health and accident insurance combined in one policy issued on the weekly premium payment plan. These Regulations as amended by T. D. 4615, and also Art. 203 (a) (2)-1, Reg. 86 (1934 Act), Art. 203 (a) (2)-1, Reg. 94 (1936 Act) and Art. 203 (a) (2)-1, Reg. 101 (1938 Act) contain this identical provision with respect to disability reserves not required by law in the case of such policies. (See Appendix, p. 32.)

The Commissioner allowed the deduction for petitioner's Disability Reserve, Active Lives for 1929 to 1932, inclusive. He allowed the deduction for petitioner's Disability Reserve, Disabled Lives for 1929 and 1930, but disallowed it for 1931 and 1932. No formal counter claim was filed, but respondent contended in the Court of Claims that the revised Regulations were applicable, and that petitioner was not entitled to any deductions for its Disability Reserve, Active Lives or its Disability Reserve, Disabled Lives for any of said years (R. 47).

The Court of Claims held that the statute permitted a deduction only with respect to life insurance reserves; that it did not comprehend disability reserves such as petitioner's Disability Reserve, Active Lives or Disability Reserve, Disabled Lives; and that the revised Regulations were applicable (R. 51-52).

Questions Presented.

1. Whether a portion of total salaries paid by petitioner to its officers and cashiers for part-time services rendered

in the investment branch of its business and charged as investment expenses may be deducted by petitioner as "investment expenses" under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932.

2. Whether petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives are "reserve funds" within the meaning of Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932.

Reasons for Granting the Writ.

Relative to Investment Expenses.

1. The Court of Claims has rendered a decision in direct conflict with its own previous decision and also in direct conflict with decisions of the Board of Tax Appeals on the identical question.

In *Sun Life Ins. Co.* v. *U. S.* (1935), 81 Ct. Cls. 892, the Court of Claims decided the identical question in favor of the taxpayer, which it decided in favor of the Government in the instant case. The Government did not petition for certiorari in the *Sun Life* case.

Previously, the Board of Tax Appeals in *Volunteer State Life Ins. Co.* v. *Com.* (1933), 27 B. T. A. 1149, had decided the question against the Government, and the Court of Claims in the *Sun Life* case expressly approved the Board's decision. Petition for review was filed by the Commissioner in the Circuit Court of Appeals for the Sixth Circuit. That court, pursuant to stipulation of the parties, reversed and remanded the cause to the Board for such orders as might be stipulated or jointly moved by the parties (35 B. T. A. 491, 493). Later the Board in *Volunteer State Life Ins. Co.* v. *Com.* (1937), 35 B. T. A. 491, followed its former decision. Petition for review by the Commissioner in the latter case is now pending in the United States Circuit Court of Appeals for the Sixth Circuit. One of the questions involved

in the latter case is *res judicata* on account of the former decision.

2. The Court of Claims has decided an important question of Federal law which has not been but should be settled by this Honorable Court.

It is admitted that the entire salary of an officer or employee would be deductible as investment expenses, if he were to devote his entire time to the investment department. The question of whether a portion of total salaries paid to officers and employees for part-time services rendered by them in the investment department and charged on the books as investment expenses may be deducted as investment expenses under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932 and corresponding provisions of other Acts is an important one to life insurance companies and to the Government. It has not been but should be settled by this Honorable Court, particularly when the Court below has decided the identical question both ways, and the Board of Tax Appeals has twice decided it contrary to the latest decision of the Court below.

RELATIVE TO RESERVE FUNDS.

1. The Court of Claims has decided an important question of Federal law in conflict with *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110.

In that case this Honorable Court held that where the Regulations from 1920 to 1934 had provided that gain accruing to a corporation on the purchase and resale of its own shares was not taxable income, the Commissioner could not change the Regulations in 1934 to provide that such gain was taxable income, and then apply the revised Regulations retroactively to the year 1929.

In the instant case, the Regulations from 1921 until 1935 authorized a deduction of the statutory percentage of the

mean of Disability Reserve, Active Lives and Disability Reserve, Disabled Lives; and the life insurance income tax return, Form 1120-L, prepared by the Commissioner contained lines for such deductions. On December 18, 1935, T. D. 4615 amended the Regulations applicable to the Revenue Act of 1932 and prior Revenue Acts by omitting therefrom the authorization for, but not expressly denying said deductions.

The Commissioner allowed petitioner the deduction for its Disability Reserve, Active Lives for 1929 to 1932, inclusive. The Commissioner allowed the deduction for petitioner's Disability Reserve, Disabled Lives for 1929 to 1930, but disallowed it for 1931 and 1932. In the Court of Claims, respondent contended that petitioner was not entitled to any deductions for its Disability Reserve, Active Lives or its Disability Reserve, Disabled Lives, for any of said years, and the Court of Claims held for the respondent (R. 18-20, 23, 59-60).

2. The Court of Claims has decided an important question of Federal law which has not been but should be settled by this Honorable Court.

The Court of Claims held that the term "reserve funds" in Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932 includes only technical life insurance reserves, and that Disability Reserves, Active Lives and Disability Reserves, Disabled Lives are excluded (R. 57). This section, however, authorizes a deduction with respect to

> "the reserve funds required by law and held at the beginning and end of the taxable year * * *"

without any restriction that the deduction shall apply only to the "reserve funds" held for life insurance alone, as the Court of Claims held (R. 57, 59-60).

Petitioner respectfully submits that this Court in *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686, and *Helvering* v. *Illinois Life Ins. Co.*, 299 U. S. 88, relied upon by the Court of Claims as establishing the proposition that only life insurance reserves are comprehended by Sec. 203 (a) (2), did not consider the question at all. These cases involved the question of whether coupon reserves and survivorship fund reserves, respectively, were reserve funds within the meaning of Sec. 203 (a) (2). This Honorable Court held that they were not essentially insurance reserves, which alone were intended by the Statute. It is not disputed that petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives are insurance reserves required by law and held for disability insurance, and the Court of Claims so found (R. 27, 29).

The Board of Tax Appeals held that the term "reserve funds" comprehends Disability Reserves, Active Lives and Disabled Lives in *Equitable Life Assurance Society* v. *Com.* (1935), 33 B. T. A. 708; *Monarch Life Ins. Co.* v. *Com.* (1938), 38 B. T. A. 716, petition for review pending in C. C. A. First; *Pan-American Life Ins. Co.* v. *Com.* (1938), 38 B. T. A. 1430, petition for review pending in C. C. A. Fifth; and *Oregon Mutual Life Ins. Co.* v. *Com.*, Docket Nos. 85,182, 88,299, memorandum opinion filed January 4, 1939, petition for review pending in C. C. A. Ninth.

This question is of importance to all life insurance companies which write policies of combined life, health and accident insurance and which are subject to the income tax imposed by Sec. 201 of the Revenue Acts of 1928 and 1932 and corresponding sections of other Acts.

Prayer.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of

Claims, commanding that court to certify and to send to this Honorable Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 43549, *New World Life Insurance Company, a Corporation* v. *The United States;* and that the said judgment of the United States Court of Claims may be reversed by this Honorable Court; and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

NEW WORLD LIFE INSURANCE COMPANY,
By WALTER E. BARTON,
Investment Building,
Washington, D. C.,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION.

Opinion Below.

The opinion of the court below (R. 32) is reported in 26 Fed. Supp. 444.

Jurisdiction.

The jurisdiction of this Court is set forth in the petition on page 1 above.

Questions Presented.

The questions presented are set forth in the petition on pages 8 and 9 above.

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in an Appendix attached to the brief.

Statement of the Case.

A statement of the case is made in the petition, beginning on page 2.

Specification of Errors to be Urged.

1. The Court of Claims erred in holding that the portion of total salaries paid by petitioner to its officers and cashiers for part-time services rendered in the investment branch of its business and charged as investment expenses during 1929 to 1932, inclusive, were not deductible as investment expenses for said years under Section 203 (a) (5) of the Revenue Acts of 1928 and 1932.

2. The court below erred in holding that the charging to investment expenses of a portion of total salaries paid by

petitioner to its officers and cashiers for part-time services rendered in the investment branch of its business during 1929 to 1932, inclusive, constituted an assignment of general expenses to investment expenses during said years within the meaning of Section 203 (a) (5) of the Revenue Acts of 1928 and 1932.

3. The court below erred in holding that petitioner was not entitled to a deduction of the statutory percentage of the mean of reserve funds required by law and held by petitioner at the beginning and end of its taxable years 1929 to 1932, inclusive, for Total and Permanent Disability Benefits, Active Lives, within the meaning of Section 203 (a) (2) of the Revenue Acts of 1928 and 1932.

4. The court below erred in holding that petitioner was not entitled to a deduction of the statutory percentage of the mean of reserve funds required by law and held by petitioner at the beginning and end of its taxable years 1929 to 1932, inclusive, for Total and Permanent Disability Benefits, Disabled Lives, within the meaning of Section 203 (a) (2) of the Revenue Acts of 1928 and 1932.

ARGUMENT.

Relative to Investment Expenses.

I.

The Court of Claims Has Decided the Question Both Ways, and the Board of Tax Appeals Has Decided It Contrary to the Latest Decision of the Court of Claims.

The Court of Claims in *Sun Life Ins. Co.* v. *U. S.* (1935), 81 Ct. Cls. 892, held that where a certain percentage of total salaries was paid to officers for services rendered in the investment department, the amount paid was deductible as investment expenses under Sec. 245 (a) (5) of the Revenue

Act of 1924. That section is the same as Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932, which reads:

> "Investment expenses paid during the taxable year: *Provided,* That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year."

The proviso regarding the assignment of general expenses to investment expenses was held by the Court of Claims in the *Sun Life* case to apply only

> "when an attempt was made to improperly increase the amount of investment expenses. The purpose of the proviso so far as we can determine from the language used and its connection with the remainder of the section is to prevent 'padding' of the investment expenses by requiring the insurance companies to make a definite showing of how much has been expended for investment purposes and how much upon the insurance business."

The Government did not file a petition for a writ of certiorari in the *Sun Life* case.

Notwithstanding its decision in the *Sun Life* case, the Court of Claims in the instant case decided the question in favor of the Government. The latest decision of the Court of Claims is contrary to the decision of the Board of Tax Appeals in *Volunteer State Life Ins. Co.* (1933), 27 B. T. A. 1149, in which the Board held that where general officers were paid specific sums for services rendered in the investment department and additional amounts for services rendered in the insurance department, the amounts paid for services performed in the investment department were de-

ductible as investment expenses. This decision of the Board was expressly approved by the Court of Claims in the *Sun Life* case. Later, in *Volunteer State Life Ins. Co.* (1937), 35 B. T. A. 491, the Board adhered to its former decision.

The Commissioner filed petition for review in the first Board case, 27 B. T. A. 1149, in the Circuit Court of Appeals for the Sixth Circuit; and that court, pursuant to stipulation of the parties, reversed and remanded the cause to the Board for such orders as might be stipulated or jointly moved by the parties (35 B. T. A. 491, 493). Later the parties filed a stipulation in the Board that the Board might find an overpayment, based in part upon the allowance of a deduction for investment expenses, representing a portion of salaries paid to officers for services rendered in the investment department. Pursuant to this stipulation, the Board entered such an order (35 B. T. A. 491, 494). Petition for review was also filed by the Commissioner in the last Board case, 35 B. T. A. 491, which is now pending in the Circuit Court of Appeals for the Sixth Circuit. One of the questions involved in the later case is whether the deductibility of a portion of officers' salaries as investment expenses is *res judicata* on account of the former decision.

In view of the uncertainty as to what the law is, as evidenced by the two contradictory decisions of the Court of Claims and the decisions of the Board of Tax Appeals, and also in view of the importance of the question, petitioner respectfully submits that this Court should grant certiorari and settle the question of whether portions of salaries paid to officers and employees for part-time services actually rendered in the investment department and charged to investment expenses are deductible as investment expenses under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932.

Relative to Reserve Funds.

I.

The Decision of the Court of Claims Is in Direct Conflict with *Helvering* v. *R. J. Reynolds Tobacco Company*, 306 U. S. 110.

In that case, this Honorable Court held that the Commissioner could not amend his Regulations in 1934 and apply them retroactively so as to require a taxpayer to include in taxable gross income for 1929 gains realized in buying and selling its own stock and bonds, where the Regulations in force from 1920 to 1934, inclusive, provided that such gains were not required to be included in taxable gross income, and the statute was reenacted without change over the period covered by the Regulations. We quote from this Court's opinion as follows:

> "The administrative construction embodied in the regulation has, since at least 1920, been uniform with respect to each of the revenue acts from that of 1913 to that of 1932, as evidenced by Treasury rulings and regulations, and decisions of the Board of Tax Appeals. In the meantime successive revenue acts have reenacted, without alteration, the definition of gross income as it stood in the Acts of 1913, 1916, and 1918. Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law.
>
> • • • • • • •
>
> "We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.
>
> • • • • • • •
>
> "Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force

of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

A similar situation obtains in the instant case. From 1921, when the present basis of taxing life insurance companies was adopted, until 1935, the Commissioner's regulations have authorized a deduction for Disability Reserves, Active Lives and Disability Reserves, Disabled Lives. (Art. 681, Reg. 62 (1921 Act); Art. 681, Reg. 65 (1924 Act); Art. 681, Reg. 69 (1926 Act); Art. 971, Reg. 74 (1928 Act); Art. 971, Reg. 77 (1932 Act).) (See Appendix, p. 32.)

On February 11, 1935, the Commissioner promulgated Art. 203 (a) (2)-1 of Reg. 86, which is applicable to the Revenue Act of 1934, *and for the first time omitted the following provision*, which had been included in the five prior regulations, beginning in 1921:

> "Generally speaking, the following will be considered reserves as contemplated by the law: Items 7-11 of the liability page of the annual statement for life insurance companies."

Lines 8 and 9 of the Annual Statement [3] for life insurance companies for the taxable years involved were as follows:

> "8. Extra reserve [4] for total and permanent disability benefits (less $—— reinsurance) $——; and for additional accidental death benefits (less $—— reinsurance) $——, included in life policies ..... $——
> "9. Present value of amounts incurred but not yet due for total and permanent disability benefits [5] (less $—— reinsurance) $——"

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[3] This Court will take judicial notice of the Annual Statement and the Federal Income Tax Return, as they are public documents required to be filed with State Insurance Commissioners and the Commissioner of Internal Revenue, respectively.

[4] This line pertains to Disability Reserve, Active Lives.

[5] This line pertains to Disability Reserve, Disabled Lives.

Furthermore, the life insurance company income tax return, Form 1120-L[3], prepared by the Commissioner to give effect to his Regulations for the taxable years 1921 to 1933, inclusive, contained the following lines for deductions:

"2. Reserve for disability[4] and accidental death benefits ..... $———

"4. Reserve for incurred disability benefits[5] $———"

Finally, on December 18, 1935, T. D. 4615 (C. B. XIV-2, pp. 310, 312) amended Art. 681 of Reg. 62, 65 and 69 and Art. 971 of Reg. 74 and 77, applicable to the revenue Acts of 1921, 1924, 1926, 1928 and 1932, respectively, by omitting the same language that was omitted from Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), and subsequently omitted from Art. 203 (a) (2)-1 of Reg. 94 (1936 Act) and Art. 203 (a) (2)-1 of Reg. 101 (1938 Act); viz:

> "Generally speaking, the following will be considered reserves as contemplated by the law: Items 7-11 of the liability page of the annual statement for life insurance companies."

The Commissioner applied the old Regulations to petitioner's taxable years 1929 to 1932, inclusive, with respect to petitioner's Disability Reserve, Active Lives, and allowed the deductions. He applied the old Regulations to 1929 and 1930 with respect to petitioner's Disability Reserve, Disabled Lives, and allowed the deductions, but he applied the revised Regulatons to petitioner's Disability Reserve, Disabled Lives for 1931 and 1932, and disallowed the deductions. Although not filing any formal counter claim, the respondent contended in the Court of Claims that the revised Regulations were applicable to all years with respect to petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives, and that the Commissioner erred in allowing any deductions on account of petitioner's

said reserve funds. The Court of Claims agreed with respondent and held that the amended Regulations applied, and that petitioner was not entitled to any deductions with respect to its Disability Reserve, Active Lives or its Disability Reserve, Disabled Lives (R. 18-21, 23, 59-60).

In Sec. 245 (a) (2) of the Revenue Acts of 1921, 1924, 1926, and in Sec. 203 (a) (2) of the Revenue Act of 1928, Congress provided for a deduction of:

> "An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only."

In 1928, this Court held in *National Life Ins. Co.* v. *U. S.*, 277 U. S. 508, that the limitation on account of exempt interest was unconstitutional. Accordingly, Sec. 203 (a) (2) of the Revenue Acts of 1932, 1934, 1936 and 1938 does not contain this limitation. Furthermore, in these Acts the percentage deduction is reduced to 3¾% in the case of life insurance companies using an interest assumption rate less than 4%. Aside from these immaterial differences, every Revenue Act from 1921 to date has contained the same provision for a deduction of 4% of the mean of reserve funds required by law and held at the beginning and end of the taxable year.

By reenacting without change throughout the entire history of the legislation the same language regarding the deduction for reserve funds, Congress must be presumed to

have given legislative approval to existing Regulations. Petitioner accordingly submits that the decision of the Court of Claims holding that the revised Regulations promulgated in 1935 were applicable to petitioner's taxable years 1929 to 1932, inclusive, is directly in conflict with the decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Co., supra.*

II.

The Decision of the Court of Claims Unduly Restricts the Decisions of This Court in *Helvering* v. *Inter-Mountain Life Insurance Company,* 294 U. S. 686, and *Helvering* v. *Illinois Life Insurance Company,* 299 U. S. 88.

In the *Inter-Mountain Life* case, this Court decided that assets held by a life insurance company against matured and unpaid coupons attached to life insurance coupon policies under which the company promised to pay the owners of the policies at their respective maturities the amounts specified, were not reserve funds within the meaning of the Act; but in reality, the equivalent of cash that the policyholders could use for the purchase of additional insurance, or otherwise obtain insurance protection. It was held that

> "in life insurance, the reserve means the amount accumulated by the company out of premium payments which is attributable to and represents the value of the life insurance elements of the policy contracts."

The above language of the court is to be read in the light of the issue presented; and concededly, there was no issue regarding the right of a life insurance company to take a deduction with respect to Disability Reserves, Active Lives or Disabled Lives. (*Webster* v. *Fall,* 266 U. S. 507,

511; *U. S.* v. *Mitchell,* 271 U. S. 9, 14; *Sinclair* v. *U. S.,* 279 U. S. 749, 767.)

That the court's opinion in the *Inter-Mountain Life* case is not to be construed as holding that a life insurance company may take a deduction only with respect to life insurance reserves is clear from the opinion of this Court in *Helvering* v. *Illinois Life Ins. Co.,* 299 U. S. 88, in which it was held that survivorship fund reserves were not reserve funds within the meaning of the Revenue Act. There the court specifically referred to its decision in the *Inter-Mountain Life* case and said:

> "That decision rests upon the ground that the reserves in respect of the coupon liability were not essentially *insurance reserves* which alone constitute the base on which deduction is computed." (Italics ours.)

The Court of Claims found that petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives were insurance reserve funds maintained out of premiums, as required by the law of the State of Washington, to meet its obligations under the disability provisions of its contracts of combined life, health and accident insurance. (R. 29, 30.) Nevertheless, the Court of Claims read into Section 203 (a) (2) the word "life," which is not there. (R. 51, 59.) This, notwithstanding the same section specifically provides for a deduction of reserve funds *not required by law* in the case of life insurance companies issuing policies covering life, health and accident insurance combined in one policy issued on the weekly premium plan. The term "reserve funds not required by law," in the last sentence of Sec. 203 (a) (2), clearly refers to reserve funds for health and accident insurance, viz., disability insurance, inasmuch as life reserves *were required by law* in all States when the Revenue Act of 1921 was enacted, that Act being

the first Act in which the present scheme for the taxation of life insurance companies was adopted.[6] The Commis-

[6] A careful examination of the statutes of the various States discloses that in 1921 life insurance companies were required to hold reserve funds for all life insurance represented by their outstanding policies. That the provision allowing a deduction for "reserve funds not required by law" was intended to apply only to reserve funds for accident and health insurance, *i. e.*, disability insurance, is shown by the following official minutes relative to Sec. 245 (a) (2) of the Revenue Act of 1921 (which corresponds to Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932):

"Dr. Adams. Let me explain that. There are developing at the present time, and have been for a few years past, companies which insure combined accident, health, and life insurance policies. There is no proper actuarial basis for it. Consequently, there are no laws stipulating what reserve shall be held against it. It is particularly necessary that there should be large reserves for it. It is a particularly dangerous form of policy for the companies and specially high reserves have to be held. Now, in all insurance in the past we have exempted only the reserves required by law. But here is a small class of companies which under a moral and real compulsion retain specially high reserves, but the law does not require any. Consequently, they come in and say, 'We want a special reserve for this purpose; we are sure that you will acquiesce.' They say this to the department and to the Congress:

'In the necessity for these reserves we are perfectly willing to let you fix them, only we want some deduction.' That is the essence of their statement."

"Senator Curtis. It authorizes the Secretary to fix the reserve if it is not fixed by law."

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"Senator Dillingham. I understand Dr. Adams says there are laws in every State of the Union regulating reserves and straight insurance companies."

"Dr. Adams. There are laws in every State of the Union fixing them absolutely."

"Senator Dillingham. But now with the new form of policy covering accidents and health the States have not adopted statutes saying what the reserve shall be in those cases."

"Dr. Adams. They have not because they do not know what they will be."

(Confidential Print for Use of Members of the Senate relative to hearings before the Committee on Finance, United States Senate, 67th Cong., 1st Sess. on H. R. 8245, an act to reduce and equalize taxation, to amend and simplify the Revenue Act of 1918, and for other purposes, September 1—October 1, 1921.)

sioner himself has recognized that this is true, because the following provision relative to reserve funds not required by law has been incorporated into all Regulations, original and amended, from 1921 to the present time:

> "In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering *disability benefits* of the kind contained in policies issued by this particular class of companies." (Italics ours.) (Appendix, p. 32, *et seq.*)

Petitioner respectfully submits that the term "reserve funds" has the same meaning in the first sentence of Sec. 203 (a) (2) that it has in the second sentence of said section; otherwise, it would be necessary to impute to Congress an intent to deny a deduction for disability reserve funds *required by law* with respect to contracts of combined life, health and accident insurance, and to allow a deduction for disability reserve funds *not required by law* with respect to such policies issued on the weekly premium plan—a construction not only not required by Sec. 203 (a) (2), but contrary to its express language.

III.

The Decision of the Court of Claims Fails to Give Effect to the General Scheme Which Congress Provided for the Taxation of Insurance Companies.

The Revenue Acts of 1928 and 1932, as well as prior Acts beginning in 1921, and subsequent Acts up to the present time, have provided for the taxation of insurance companies under three different classifications. Under the Revenue Acts of 1928 and 1932 and corresponding sections

of prior and subsequent Acts, life insurance companies are taxed under Sections 201, 202 and 203; insurance companies other than life or mutual under Section 204; and mutual insurance companies other than life under Sections 207 and 208. (See Appendix, p. 30.)

Life insurance companies include in gross income only income from investments, such as dividends, interest and rents, excluding therefrom premium income. (Sec. 202 (a).) They are not allowed any deduction for amounts actually paid to policyholders in satisfaction of claims when they mature; but life insurance companies are allowed a deduction of an amount equal to 3¾% or 4% of the mean of reserve funds which are set up for the purpose of enabling them to pay claims under their policies when they mature. (Sec. 203 (a) (2).) Life insurance companies, therefore, are not taxed on premium receipts or on that portion of investment income added to reserve funds to pay policyholders' claims.

Insurance companies other than life or mutual include in gross income investment income and premiums earned. (Sec. 204 (b) (1)-(5).) They are allowed deductions for "losses incurred," i. e., the amounts which they actually pay to policyholders. (Sec. 204 (b) (6).) Insurance companies other than life or mutual, therefore, are not taxed on that portion of premium receipts or investment income used to pay policyholders' claims.

Mutual insurance companies other than life include in gross income investment income and premium income. (Sec. 208 (a).) They are permitted to deduct "the net addition required by law to be made within the taxable year to reserve funds." (Sec. 208 (c) (1).) These companies are not allowed any deduction for amounts actually paid to policyholders, but they are given a deduction of that portion of premium receipts and investment income

which is set aside to provide for the payment of policy claims when they mature.

Thus it will be seen that under each of the three methods of taxing insurance companies, Congress has not taxed any class of insurance company on that portion of premium receipts and investment income which is paid over to the policyholders in fulfillment of its insurance obligations. The method of accomplishing this varies; but the result is the same. For instance, life insurance companies and mutual insurance companies other than life get their exclusions or deductions from gross income at the time when the amounts are set aside in reserve funds; whereas, insurance companies other than life or mutual get their deductions in the form of losses incurred during the taxable year on insurance contracts, these losses consisting of payments made out of premium receipts and investment income.

In attempting to understand what Congress intended by "reserve funds" in Section 203 (a) (2), the general scheme of taxing insurance companies should be kept in mind. The decision of the Court of Claims in the instant case is out of harmony with this plan; because the Court has denied the petitioner a deduction for that part of its investment income credited to its reserve funds and held to satisfy its contingent and unaccrued obligations under the disability provisions of its contracts of combined life, health and accident insurance. If the petitioner were taxable as an insurance company other than life or mutual, it would be allowed a corresponding deduction for "losses incurred," and if it were taxable as a mutual insurance company other than life, it would be entitled to a corresponding deduction as "net addition * * * to reserve funds." It should not be presumed that Congress intended to deny a life insurance company a deduction which all other insurance companies receive. Clearly, such an inequitable result should not be presumed in the absence of express language.

Petitioner respectfully submits that the construction for which it contends is the only reasonable one; because Congress has not limited or qualified the meaning of the term "reserve funds" in Section 203 (a) (2). Consequently, the words should be given their unqualified meaning, which is the only one that is in harmony with the general scheme of taxation which Congress has provided for all insurance companies from 1921 to the present day.

IV.

The Decision of the Court of Claims is in Conflict with Decisions of the United States Board of Tax Appeals.

The Board of Tax Appeals in well-reasoned opinions in *Equitable Life Assurance Society* v. *Com.* (1935), 33 B. T. A. 708; *Monarch Life Ins. Co.* v. *Com.* (1938), 38 B. T. A. 716 (petition for review pending in C. C. A. First); *Pan-American Life Ins. Co.* v. *Com.* (1938), 38 B. T. A. 1430 (petition for review pending in C. C. A. Fifth); and *Oregon Mutual Life Ins. Co.* v. *Com.* (1939), memorandum opinion filed January 4, 1939, Docket Nos. 85,182, 88,299 (petition for review pending in C. C. A. Ninth), held that disability reserves, such as petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives, are reserve funds within the meaning of Sec. 203 (a) (2) and corresponding sections of the Revenue Acts.

Inasmuch as a large number of life insurance companies write disability insurance in contracts of combined life, health and accident insurance, the question is one which will continue to be presented to the various courts and the Board of Tax Appeals until this Court has settled the question. Final adjudication of the question, therefore, is of importance to most of the life insurance companies in the United States, as well as to the Government.

Conclusion.

It is respectfully submitted that the decision of the Court of Claims is erroneous, and that the foregoing petition for a writ of certiorari should be granted.

WALTER E. BARTON,
Investment Building,
Washington, D. C.,
Counsel for Petitioner.

APPENDIX.

Statutes.

REVENUE ACTS OF 1928 AND 1932.

(The sections are the same in both Acts, except Sec. 203 (a) (1) and (2).)

SEC. 201. Tax on life insurance companies.

(a) Definition.—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

SEC. 202. Gross income of life insurance companies.

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

SEC. 203. Net income of life insurance companies.

(a) General rule.—In the case of a life insurance company the term "net income" means the gross income less—

(1)[7] Tax-free interest.—The amount of interest received during the taxable year which under section 22 (b) is exempt from taxation under this title;

(1)[8] Tax-free interest.—The amount of interest received during the taxable year which under section 22 (b) is exempt from the taxes imposed by this title;

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[7] The following is Sec. 203 (a) (1) of the Revenue Act of 1928. Sec. 203 (a) (1) of the Revenue Act of 1932 follows.

[8] The following is Sec. 203 (a) (1) of the Revenue Act of 1932. Sec. 203 (a) (1) of the Revenue Act of 1928 is immediately above.

SEC. 203 (a) (2).[9] Reserve funds.—An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

SEC. 203 (a) (2).[10] Reserve funds.—An amount equal to 4 per centum of the mean of the reserve fund required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3¾ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

SEC. 203 (a) (5). Investment expenses.—Investment expenses paid during the taxable year: *Provided,* That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

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[9] The following is Sec. 203 (a) (2) of the Revenue Act of 1928. Sec. 203 (a) (2) of the Revenue Act of 1932 follows.

[10] The following is Sec. 203 (a) (2) of the Revenue Act of 1932. Sec. 203 (a) (2) of the Revenue Act of 1928 is immediately above.

Regulations.

Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act) prior to amendment, as hereinafter referred to, were the same and read as follows:

"Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

"(1) Interest which is exempted in the case of other taxpayers by section 22 (b) (4) and articles 84-87;[11] and

"(2) Four per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per cent shall be substituted for 4 per cent. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

"In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is 3¾ per cent of the mean of such reserve

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[11] 88 in Art. 971 of Reg. 74.

funds held at the beginning and end of the taxable year. Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual Statement. Generally speaking, the following will be considered reserves as contemplated by the law: *Items 7-11 of the liability page of the annual statement for life insurance companies, and items 16-19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business.* If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered." (Italics ours.)

In all material respects, Art. 681 of Reg. 62 (1921 Act), Art. 681 of Reg. 65 (1924 Act) and Art. 681 of Reg. 69 (1926 Act) prior to amendment, as hereinafter referred to, were the same as Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act), *supra.*

On February 11, 1935, Art. 203 (a) (2)-1 of Reg. 86 (1934 Act) was promulgated, which reads as follows:

"In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future un-

accrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.

"In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered. A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

"In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering

disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is 3¾ per cent of the mean of such reserve funds held at the beginning and end of the taxable year."

Later the Commissioner promulgated Art. 203 (a) (2)-1 of Reg. 94 (1936 Act) and Art. 203 (a) (2)-1 of Reg. 101 (1938 Act), which articles were exactly the same as Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), *supra*. It will be observed that Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), 94 (1936 Act) and 101 (1938 Act) omitted the language which we italicized of Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act), and which was also contained in Art. 681 of Reg. 62 (1921 Act), Art. 681 of Reg. 65 (1924 Act) and Art. 681 of Reg. 69 (1926 Act), *supra*. On December 18, 1935 the last-mentioned Regulations, namely, Art. 681 of Reg. 62 (1921 Act), 65 (1924 Act) and 69 (1926 Act), and Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act) were amended by T. D. 4615 to read in all material respects the same as Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), 94 (1936 Act) and 101 (1938 Act), omitting therefrom the italicized language referred to which was contained in said Regulations prior to amendment by T. D. 4615.